



UNIVERSITI PUTRA MALAYSIA

**DETERMINANTS OF CONSUMERS'
CHOICE OF ISLAMIC FINANCING PRODUCTS**

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**DETERMINANTS OF CONSUMERS' CHOICE OF ISLAMIC FINANCING
PRODUCTS**

By

SAMSUWATD ZUHA BINTI MOHD ABBAS

**Thesis Submitted to the Graduate School of Management,
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November 2003

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The Islamic banking has been in Malaysia since the set up of the first Islamic bank on 1st March 1983. Ten years later, the Malaysian government launched the Interest Free Banking Scheme (SPTF), which later renamed Islamic Banking Scheme (SPI). Today, the consumers' acceptance toward the Islamic banking system especially the financing section is still below the target set by the government. In analyzing why the consumers' are not taking Islamic financing, the study had focus to factors that determine consumers' choice.

Studies that had been conducted were on the factors that influence customers' selection for a bank is directly related to the factors determining consumers' choice. The researchers identified various factors such as the quality of bank products and services, existence of branches, friendliness or customers' relation, availability of credit, friend's recommendation, location, speed of processing, uncertainty of return and risk involved, customers' awareness, publicity of products and availability of products.

Therefore the main objective of the study is to determine factors that determine consumers' choice in selecting Islamic financing products introduced by the commercial banks. In order to determine the choice, the study will analyse the reasons that determine consumers' choice toward Islamic financing products. The reasons were derived from the literatures and interviews conducted with the bankers.

A set of questionnaire was designed and distributed to the public. A total of 269 completed questionnaires were returned from 500 questionnaires distributed. In analyzing the results of the research various methods had been used. Among them were the Pearson Correlation, factor analysis and regression analysis. The Pearson Correlation is used to determine the relationship among the variables that determine customers' choice, to measure the strength of association between two variables and determine the degree to which the variables are related. The factor analysis was used to determine the reasons that influence their choice toward Islamic financing products and reduce the 24 reasons (variables) into 6 factors. The 6 factors comprised of Factor 1 "staff", Factor 2 "application process", Factor 3 "customer awareness and knowledge", Factor 4 "customer preference", Factor 5 "risk and return", and Factor 6 "products offering". The factor analysis results indicate that the staff factor such as inefficient, unfriendly, unknowledgeable staff is the main contributors that determine consumers' choice toward Islamic financing. The staff factor contributes 30.044% as compared to other factors that are less than 12.0%. Lastly the discriminant analysis is used to determine the relationship that best distinguish (discriminate) between choosing Islamic financing and conventional financing with the factors determining customers' choice. The discriminant analysis results show that Factor 4 Customer's Preference has the highest positive

standardized coefficient of 0.667 followed by Factor 2 Application Process 0.381 and Factor 3 Customer's Awareness and Knowledge 0.331. This means that all the three factors had greater contribution in discriminating the groups between Islamic financing products and conventional financing products.

Abstrak thesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

**FAKTOR YANG MENENTUKAN PILIHAN PELANGGAN DALAM
MEMILIH PRODUK PEMBIAYAAN ISLAM**

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Objektif sistem perbankan dan kewangan Islam adalah untuk menggalakkan keadilan ekonomi, keselarasan dan keamanan dalam masyarakat disamping membawa kebaikan untuk pelanggan. Akan tetapi perkara ini seolah-olahnya tidak berlaku didalam masyarakat Malaysia. Walaupun Bank Islam yang pertama telah ditubuhkan pada 1hb March 1983 dan sepuluh tahun kemudian kerajaan telah melaksanakan sistem perbankan Islam dibank-bank yang lain. Malangnya, penerimaan masyarakat terhadap sistem ini masih tidak memenuhi matlamat yang di tetapkan oleh kerajaan. Dalam mencari sebab-sebab mengapa pelanggan tidak mengambil pembiayaan Islam, kajian ini telah memfokuskan kepada faktor yang mempengaruhi pilihan pelanggan. Kebanyakan kajian-kajian awal yang dibuat semuanya adalah berkenaan dengan factor-faktor mempengaruhi pilihan pelanggan terhadap bank. Malah kajian ini berkait rapat dengan faktor ygng menentukan pilihan pelanggan terhadap bank. Antara faktor-faktor nya ialah masa menunggu, operasi yang efisien, pelbagai produk, qualiti produk dan servis, harga produk dan produk yang fleksibel. Kesemua faktor yang dinyatakan adalah sama dengan faktor-faktor yang mempengaruhi pelanggan dalam pemilihan bank. Faktor-faktor yang dikesan dari kajian-kajian yang

telah dibuat ialah qualiti produk dan servis bank, adanya cawangan, kemesraan atau hubungan pelanggan, adanya pembiayaan kredit, saranan dari kawan, lokasi, kelajuan memproses, ketidak tentuan pulangan dan risiko yang terlibat, kesedaran pelanggan, publisiti produk dan produk yang tersedia.

Oleh itu objektif kajian ini dibuat adalah mengetahui apakah faktor-faktor yang menentukan pilihan pelanggan terhadap pembiayaan Islam. Dalam menentukan pilihan pelanggan, kajian ini akan mengkaji sebab-sebab tidak memilih pembiayaan Islam. Sebab-sebab itu didapati dari pengajian penyelidikan-penyelidik dan temuramah dengan pihak bank.

Dalam mencari sebab-sebab mengapa tidak memilih pembiayaan Islam, set soalan diedarkan pada orang awam dan beberapa teknik telah digunakan untuk penganalisan data. Teknik yang digunakan adalah “Pearson Correlation, Factor Analysis, dan Discriminant Analysis.” Pearson Correlation digunakan untuk mengukur kekuatan perhubungan antara dua “variable” dan menentukan sejauh mana “variable” itu berkaitan. Faktor analisis digunakan untuk meringkaskan 24 penyebab kepada 6 faktor penyebab utama sahaja. Analisa discriminant digunakan untuk menentukan hubungan yang membezakan antara faktor pilihan pembiayaan Islam atau pembiayaan konvensional dengan faktor-faktor yang mempengaruhi pilihan pelanggan. Dari kajian ini, didapati factor 4 keutaaman pelanggan adalah faktor penyebab utama yang membezakan samada pelanggan akan memilih pembiayaan Islam ataupun Pembiayaan Konvensional.

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I certify that an Examination Committee met on **5th September 2003** to conduct the final examination of **Samsuwatd Zuha bte Mohd Abbas** on her **Master of Science** thesis entitled **“Determinants of Consumers’ Choice of Islamic Financing Products”** in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulation 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations, which has been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

**SAMSUWATD ZUHA BINTI MOHD ABBAS**

Date: 5th November 2023

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LIST OF ABBREVIATIONS

BAFIA	Banking And Financial Institution Act
BBA	Al Bai Bithaman Ajil
BBMB	Bank Bumiputra Malaysia Bhd.
BCB	Bumiputra Commerce Bhd.
BIMB	Bank Islam Malaysia Bhd.
BNM	Bank Negara Malaysia
CFP	Conventional Financing Products
F	Factor
IBA	Islamic Banking Act
IBD	Islamic Banking Division
IBS	Islamic Banking Scheme
IBU	Islamic Banking Unit
IFP	Islamic Financial Product
IFBS	Interest Free Banking Scheme
PMFB	Pilgrim Management Fund Board
SPI	Skim Perbankan Islam
SPTF	Skim Perbankan Tanpa Faedah
TV	Television

CHAPTER 1

INTRODUCTION

Background of Study

Islamic banking has been in Malaysia since the first Islamic bank was set up in March 1983. In order to set up an Islamic banking system, the government through Bank Negara Malaysia (BNM) had gradually implemented measures to provide the necessary infrastructure by optimizing available resources. The first step was to disseminate Islamic banking on a nation wide basis with as many players as possible and within the shortest period possible. This was done through the launching of the Skim Perbankan Tanpa Faedah (SPTF) or the Interest Free Banking Scheme (IFBS) by the BNM in March 1993. The launching of the SPTF was to stimulate growth in the Islamic banking. Under this scheme the conventional banking institutions are allowed to offer Islamic banking products and services using their existing infrastructure including staff and branches.

Although the BNM had gradually implemented measures to ensure the growth in Islamic banking yet the acceptance of the public toward the Islamic financing is far below the target set by the BNM. The BNM in its 1995 directives to all banking institutions stated that all participating banks in the Interest Free Banking Scheme (IFBS) or Islamic Banking Scheme (IBS) were required to meet the 5% quota for Islamic banking in their banking operations by the year 2000. The 5% target for Islamic banking includes financing and deposit. From the data given by Islamic Banking Division of the BNM, the 5% target on financing was not met by most of the commercial banks in the country. Thus, there is a need for a study to be

conducted among financial institutions especially the commercial banks to analyse the reasons as to why the public are not choosing Islamic financing.

Problem Statement

The first Islamic bank in Malaysia was established in July 1983. Ten years later, on 4th March 1993 the government gradually expanded Islamic banking to other banking institutions such as the commercial banks, finance companies, merchant bankers, discount houses and other financial intermediaries. This was done through the introduction of IFBS or SPTF in March 1993 and it was later renamed to IBS or SPI in January 1999. Although the Islamic banking has been in the market for more than a decade, the acceptance of the public towards the system (i.e the interest-free-banking scheme) is far below the target set by BNM. Yet no documents exist suggesting the causes of the stagnation in the Islamic banking. BNM in its 1995 directives to all banking institutions stated that all participating banks in the IFBS or SPTF were required to meet the 5% quota for Islamic banking in their banking operations (*Appendix A*). The 5% target for Islamic banking includes financing and deposit. The statistic as of 31st Dec 1999, shows that Islamic banking only accounts for 5.2% of the total deposits in the country¹ and the financing only accounts for 3.0 % of the total financing in the banking system. The above statistics on Islamic banking was for all the banking institutions in the country, which include the commercial banks, finance companies, merchant bankers and discount houses. Likewise, if the statistic of Islamic banking was taken for the commercial banks, the

¹ Ismail Hashim, Finance Ministry Secretary: *The Star* 28th July 2000



results will still show that the overall performance of Islamic banking was far below the conventional banking and most of the commercial banks did not meet BNM 5% target especially in financing.

Even though there were directives issued by BNM to all participating commercial banks to meet the 5% quota by year 2000, the overall achievement of this quota is not met by most of the commercial banks yet. Table 1.1 shows the statistics of the substantial contributors in Islamic financing in the commercial banks. As of 30th June 2000, it shows that only 6 commercial banks met the BNM quota. Bank Islam is the major contributor in Islamic financing with 40.9% followed by Maybank with 16.1% and Bank Muamalat with 9.7%.

Table 1.1: List of Substantial Contributors in Islamic Financing in the Commercial Banks

	Statistic as at : List of Banks	31/12/99 %	30/06/00 %
1	Bank Islam Malaysia Bhd	40.9	36.55
2	Maybank	16.1	15.96
3	Bank Muamalat Bhd	9.7	11.05
4	Arab Malaysian Bank	6.7	5.42
5	BSN Commercial	5.0	5.13
6	RHB Bank	5.5	10.04
7	Perwira Affin Bank	5.6	4.83
8	Public Bank	< 2.0%	2.84
9	Other Commercial Banks	0.01 to 2.00	0.01 to 2.00
	Total	89.5	88.53

Source: Supervision Department BNM September 2000

Since the Islamic banking was introduced to other financial institutions in 1993, the assets, deposits and financing total had been on the increasing trend but the financing fails to meet the BNM quota. Table 1.2 shows the amount of total assets, total financing and total deposits in the commercial banks since 4th March 1993. The Islamic financing only accounts for about 4.77% of the total financing in the commercial banks.

Table 1.2: List of Total Asset, Total Deposit and Total Financing of the Islamic Banking in the Commercial Bank as of 31st December from 1993 to 2000

Year 31st Dec	Total Asset (RM million)	Total Deposits (RM million)	Total Financing (RM million)	No of Commercial Bank with SPI excluding Bank Islam
1993	2,148	2,050	1,092	-
1994	3,248	4,355	1,514	22 (Bank Islam :1)
1995	5,287	4,490	2,809	24 (Bank Islam :1)
1996	7,615	5,950	4,525	26 (Bank Islam :1)
1997	14,280	8,781	8,057	25 (Bank Islam :1)
1998	17,533	13,148	8,414	26 (Bank Islam :1)
1999	27,065	20,079	10,233	22 (Bank Islam :2)
2000	34,123	27,395	15,032	21 (Bank Islam :2)

Source : Bank Negara Malaysia Annual Report 1993 to 2000

Table 1.3 shows the amount of total assets, total financing and total deposits in the conventional banking of the commercial banks. The data shows that the assets, deposits and financing total are on the increasing trend except during 1998 when the country was facing economic crisis, the assets total show a decrease of about 5.6% compared to the total for 1997.

Table 1.3: List of the Total Assets, Total Deposits and Total Financing in the Conventional Banking of the Commercial Banks as of 31st December 1993 to 2000

Year: 31st Dec	Total Asset (RM million)	Total Deposits (RM million)	Total Financing (RM million)
1993	222,237.30	132,211	117,235.50
1994	239,236.70	151,071	134,151.00
1995	292,211.90	187,239	175,007.50
1996	358,083.80	232,151	217,820.50
1997	480,248.10	300,558	289,756.70
1998	453,492.00	307,440	299,146.20
1999	482,738.30	339,945	295,870.30
2000	513,572.50	362,968	314,959.20

Source: Bank Negara Malaysia Monthly Statistical Bulletin: August 1999/February 2001

Table 1.4 shows the percentage of Islamic financing growth as compared to the conventional financing growth of the commercial banks. The data shows that the growth in Islamic financing is much higher than the conventional banks. In 1995, the Islamic financing recorded the highest growth of 86%.

Table 1.4: List of growth rate in Islamic financing and conventional financing in Malaysia from 31st December 1994 to 31st December 2000

Year: 31st Dec	% of financing growth in Islamic banking	% of conventional financing growth in commercial banking
1993	-	-
1994	38%	14%
1995	86%	30%
1996	61%	24%
1997	78%	26%
1998	4%	3%
1999	22%	2%
2000	32%	7%

Source : Bank Negara Malaysia Annual Report 1993 to 2000

Table 1.5 shows the percentage of total financing, total deposit and total asset in the Islamic Banking Scheme as compared to the conventional banking of the commercial banks.

Table 1.5 : List of percentage in Islamic banking financing as compared to conventional financing in the commercial banks from 31st December 1993 to 31st December 2000

Year: 31st Dec	% of Islamic banking financing as compared to conventional banking financing	% of Islamic banking deposits as compared to conventional banking deposits	% of Islamic banking assets as compared to conventional banking assets
1993	0.94%	1.67%	1.07%
1994	1.14%	2.88%	2.03%
1995	1.63%	2.40%	1.84%
1996	2.12%	2.56%	2.17%
1997	3.00%	2.92%	3.06%
1998	3.03%	4.28%	4.02%
1999	3.61%	6.80%	6.16%
2000	4.77%	7.55%	6.64%

Source : Bank Negara Malaysia Annual Report 1993 to 2000

From Table 1.5 it is clear that the financing part of the Islamic banking is not reaching the target of 5% required by the BNM directives by year 2000. Moreover as exhibited in Table 1.1 there are very few banks that achieve the 5% target. Although there are 21 commercial banks and 2 Islamic banks, only 6 banks achieved this target. Most of the commercial banks fall in the range of 0.1% to 2.0% only. Therefore in analyzing the failure of meeting the 5% quota, there are three parties involved. The three parties are the government or the policy maker, the banks and the customers. This research will focus on factors that are attributed to the customers only since it is much easier to get the data as compared to the other two parties. The

banks are governed by the Duty of Secrecy of the BAFIA 1989 and the government is by the Official Secrets Act 1972 and the administrative circulars issued by the government. Therefore it is a major concern to the researcher as to why the banks fail to meet the quota (from the perspective of the customers)? Could it possibly be due to the following reasons?

1. The public is not aware (ignorant) of the system
2. The banking institutions are not promoting enough of the Islamic banking
3. The products offered are not competitive as in the conventional banking
4. The products offered are not cheap
5. The products offered by the participating banks do not tailor/meet the need of the customers.
6. The products offered by the banks are very limited or too few products offered under the Islamic banking
7. The staff from the Islamic banking department is not able to sell the products due to their ignorance of the system

According to Abdul Kader's (1993) findings, the present package of Islamic banking services offered by BIMB does not seem to fulfill the banking needs of these Muslim. Furthermore, her findings found that high proportion of Muslim depositors of interest-based banks did not have a clear understanding of the true concept of Riba. Moreover they are relatively less committed in avoiding Riba in their banking transactions. Although Abdul Kader's study mentioned the products and services offered by the BIMB, the basis of all Islamic banking products and services in the commercial bank currently were mainly derived from BIMB. Moreover, the BIMB

research institute (a subsidiary of BIMB) acts as the advisor to most commercial banks that implement Islamic banking.

Harun (1997) stated that the establishment of Islamic banks should be a great help to the public at large and the Muslims especially in the area of financing. Furthermore, he stated that in the process of conducting business, Islamic banks seek to bring about the lasting balance between earning and spending in order to achieve the target of the betterment of the whole community. Therefore, in dealing with customers, Islamic banks are expected to conduct the transactions for the benefit of both i.e. justice to the bank and the customers.

The existence of Islamic bank is to achieve the betterment of the community as a whole but the above statistical figures that show such a low percentage of Islamic banking as compared to conventional banking. We will be wondering why the community is not taking advantage of the system.

According to Ahmad and Harun, (1997) in order to penetrate and operate side by side with these conventional banks, Islamic banks must be able to change the people perceptions that their system is much better than the conventional system.

Although there are several researchers in Malaysia such as Kamaluddin (1988), Chin (1992) and Anwar (1993) who have done research on customers' banking selection, it does not address the issue of why the consumers do not choose Islamic financing products that are available at conventional and Islamic banks. Even Abdul Kader (1997) only covers the marketability of the products offered by BIMB alone.

Therefore there is a need for a study to address the following issues: firstly, what are the reasons that determine consumers' decision for not choosing Islamic financing products. Secondly, what is the relationship between consumers' choice and the reasons that influence consumers in choosing Islamic financing products?

Objective of the study

This objective of this study is to analyse reasons for the failure of commercial banks to meet the BNM quota of 5% in the Islamic financing. In analysing this failure there are three parties involved. They are the government, bankers and customers. Therefore the study will focus on factors that are attributed to the customers only since it is much easier to get the data. Moreover the Duty of Secrecy of the BAFIA 1989 governs the banks and the government is by the Official Secrets Act 1972. The main objective of the study is to identify the factors determining consumers' choice in selecting Islamic financing products. The analysis will focus on the reasons why the consumers are not choosing Islamic financing products. More specifically the main objectives of this study are outlined as follow:

1. To determine the factors that influence consumers in choosing Islamic financing products.
2. To examine the relationship that best distinguish (discriminate) between choosing Islamic financing or conventional financing with the factors that influence consumers in choosing Islamic financing products.

Significance of the Study

So far there is no research done specifically for Islamic financing products and we cannot find published research in this area. Most of the earlier research discussed on